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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 9, 1997

BY HAND DELIVERY

Mr. William F. Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128

Dear Mr. Caton:

Please find enclosed for filing an original and four copies of the Reply Comments of the RBOC/GTE/SNET Payphone Coalition.

Please date-stamp and return the extra copy provided in the attached separate envelope.

Sincerely,

Michael K. Kellogg

Michael K. Kellogg

Enclosures

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of

Implementation of the Pay Telephone	)	
Reclassification and Compensation	)	CC Docket No. 96-128
Provisions of the	)	
Telecommunications Act of 1996	)	

REPLY COMMENTS OF THE RBOC/GTE/SNET PAYPHONE COALITION

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EXECUTIVE SUMMARY

I. Congress and the Commission already have concluded that competition, not regulation, is the best means of "promot[ing] the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1). As the Commission concluded, "market-based pricing will result in a greater availability of payphones at more economically efficient prices, which will ultimately benefit callers." Recon. Order, 11 FCC Rcd at 21265, ¶ 61.

Despite this appropriate judgment, several commenters have argued that the Commission should ignore evidence of competitive, market-based outcomes and base per-call compensation on a regulatory, cost-based methodology. None of these commenters, however, explain how these regulatory, cost-based approaches are consistent with competitive outcomes. Nor do they explain how such an approach would promote the widespread deployment of payphones. They do not because they cannot. Simply put, a cost-based approach is utterly inconsistent with Congress's commands of fair compensation, maximum competition, minimal regulation, and the "widespread deployment" of payphones. As the Commission correctly concluded before, because a cost-based compensation standard would put the industry in a cost-accounting straightjacket and embroil the Commission in lengthy, time-consuming, and contentious periodic cost reviews, the burdens are "completely disproportionate to any benefits offered" thereby. Second Report and Order, 7 FCC Rcd at 3256, ¶ 32. Besides, "a cost-based compensation standard could lead to a reduction in payphones by limiting a PSP's recovery of its costs, and this result would be at odds with the legislative purpose of Section 276 [to] 'promote the widespread deployment of payphone services to the benefit of the general public.'" Recon. Order, 11 FCC Rcd at 21267, ¶ 66. The Commission therefore correctly chose to rely on a "market-based approach" that would accommodate the "likely cost variations" from "payphone to payphone." Id. at 21268, ¶ 71. It should do the same thing now on remand.

Unable to explain why a cost-based approach is consistent with the goals Congress established or the public interest generally, many commenters argue that the Court of Appeals mandated the use of a regulatory fully-allocated cost methodology. Not so. The Court of Appeals nowhere disturbed the Commission's general conclusion that market-determined prices were a better surrogate for per-call compensation than costs. The Court questioned only the Commission's use of the deregulated local coin rate as a proxy for per-call compensation, holding that the Commission had improperly failed to address record evidence indicating that there were potentially significant differences between local coin call costs and subscriber 800 and dial-around calls. See Illinois Pub. Telecom. Ass'n v. FCC, 117 F.3d 555, 564 (D.C. Cir. 1997).

As the Coalition explained in its opening comments, however, any principled adjustment to account for the differences between local coin calls on the one hand and subscriber 800 and access code calls on the other requires the Commission to increase rather than decrease the per-call compensation rate. The Coalition, the APCC, and the independent payphone companies all point out that the net avoided cost of subscriber 800 and access code calls, as compared to local coin calls, is actually *negative*. That is, subscriber 800 and access code calls on the whole impose more costs compared to local coin calls than they avoid.

Moreover, looking only to cost differences would result in unrealistically low, sub-market pricing. Competitive firms in a competitive market with a high proportion of joint and common costs -- like the payphone market -- would base prices not only on cost but also on the relative conditions of demand. Because the derived demand elasticity for subscriber 800 calls and access code calls is much lower than that of local coin calls, joint and common costs would tend to be recovered from subscriber 800 and access code calls rather than local coin calls. As a result, a competitive market would price access code and subscriber 800 calls at least $.07 cents per call above the local coin rate. See Comments of the RBOC/GTE/SNET Payphone Coalition at 15-24 (Aug. 26, 1997). Because this competitive market rate will lead to efficient payphone deployment and maximize consumer welfare consistent with Congress's commands -- and because the market rate *is* the "fair" rate -- the Commission should set per-call compensation prices at least $.07 above the local coin rate.

In any event, even if the Commission were to ignore Congress's deregulatory mandate and adopt a cost-based approach to per-call compensation, the cost estimates submitted by the interexchange carriers are wholly unrealistic. As the attached report from Arthur Andersen demonstrates, the interexchange carriers' cost studies (such as AT&T's Robinson Affidavit or MCI's Hatfield Study) underestimate actual costs, arbitrarily exclude entire categories of costs, and manipulate call counts in order to arrive at an arbitrarily low estimate. While other interexchange carriers rely on the *result* of a Massachusetts cost study but not the study itself, they ignore the fact that the study looks only to *incremental costs* (and thus excludes large fixed and joint and common costs), a methodology the Commission already has rejected. More important still, that study reflects only the incremental costs of providing service in a state like Massachusetts and is wholly unrepresentative of costs in the rest of the country. If the Commission is going to rely on a regulatory costing approach, it must look to the total costs incurred by actual PSPs operating throughout the nation, not the incremental costs that would be incurred in one unrepresentative state. The national and regional cost data submitted by actual PSPs, including Coalition members, the APCC's members, Peoples Telephone, and others, show that even cost-based per-call compensation should exceed the prevailing competitive local coin rate.

II. Various carriers also attempt to escape their interim compensation obligations, suggesting either that interim compensation be abandoned or that the Commission adopt a methodology that will minimize their portion of interim compensation. But the Commission cannot abandon interim compensation consistent with Congress's statutory commands. The statute requires that LEC subsidies be eliminated "in favor of" per-call compensation; nowhere does it empower the Commission to eliminate payphone cost recovery for LECs "in favor of" no compensation at all. 47 U.S.C. § 276(b)(1)(B). Nor can the Commission abandon interim compensation consistent with the requirement that there be fair compensation for "each and every" completed call. Id. § 276(b)(1)(A).

Similarly, the Commission must reject the interexchange carriers' request that interim compensation burdens be allocated to LECs based on total toll revenues. This is precisely the method rejected by the Court of Appeals. Moreover, it would be wholly arbitrary. While LECs account for about 12 percent of total toll revenues, they account for less than 3 percent of access code and subscriber 800 calls. Coalition members are willing to pay their fair share of interim compensation. But they will not pay -- and the Commission cannot require them to pay -- some of AT&T's and MCI's fair share as well.

III. No party has filed comments disagreeing with the Commission's tentative conclusion that net book valuation is appropriate for payphone assets reallocated or transferred to a separate subsidiary. The Commission consistently has applied the net-book valuation methodology when detariffing CPE (like payphone CPE) in the past, and reason and precedent alike require its application here. Accordingly, the net book valuation standard should be applied.

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REPLY COMMENTS OF THE
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The Telecommunications Act of 1996 sought to create a "pro-competitive, de-regulatory national policy framework" for the telecommunications industry. See S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 1 (1996). Heeding this congressional mandate, the Commission deregulated local coin rates for pay telephones and established a market-based system that provides fair compensation for each and every call placed from a payphone. Over numerous petitions for review, the Court of Appeals for the District of Columbia Circuit subsequently affirmed the general framework established by the Commission. See Illinois Pub. Telecom. Ass'n v. FCC, 117 F.3d 555 (D.C. Cir. 1997). Only a few limited issues were returned to the Commission on remand.

In submitting comments in response to the Commission's August 5, 1997 Public Notice, DA 97-1673 ("Remand Notice"), the interexchange carriers urge the Commission to relinquish any attempt at fulfilling Congress's deregulatory mandate. These carriers instead propose a cost-based approach to per-call compensation, reiterating the very same arguments they made a year ago. Just as the Commission rejected the carriers' arguments then, it should do so again now. As the RBOC Coalition explained in its July 1, 1996 Comments, competition among payphone providers will promote the widespread deployment of payphone services, ensure efficient, affordable service, create high-quality jobs, and ensure economic growth for the benefit of the general public. See Comments of the RBOC Payphone Coalition at i, 9, 20-23, 50 (FCC July 1, 1996) ("RBOC Coalition 1996 Comments"). By contrast, a cost-based approach would mire the Commission in an endless stream of complex regulatory battles and depress payphone deployment below competitive levels, subverting Congress's goal of "promot[ing] the widespread deployment of pay telephone services." 47 U.S.C. § 276(b); see RBOC Coalition 1996 Comments at 13-16; Comments of the RBOC/GTE/SNET Payphone Coalition at 27-30 (FCC Aug. 26, 1997) ("Coalition Remand Comments"). For these reasons, the Commission should reject the carriers' calls for a cost-based approach to per-call compensation and should keep competition and competitive rates as its lodestar.[1]

Besides, the cost estimates provided by the interexchange carriers grievously mischaracterize payphone costs so as to produce per-call compensation rates well below those that the market would provide. Even though the blatant errors in the interexchange carriers' analysis repeatedly were pointed out when they submitted virtually identical studies in 1996, they attempt to foist precisely the same incorrect estimates on the Commission once again, and without so much as a gesture in the direction of correcting even their most obvious mistakes. Once those errors are corrected, moreover, even the interexchange carriers' cost studies support

[1]. The Commission also must reject suggestions that it abandon its carrier-pays compensation scheme. Further Comments of the Personal Communications Industry Ass'n at 9-14 ("PCIA Comments"). That portion of the Commission's orders was upheld by the Court of Appeals, Illinois Pub. Telecom, 117 F.3d at 566-67, and the PCIA offers no arguments the Commission has not heard and rejected before.

per-call compensation that equals or exceeds the prevailing, competitively established, local coin rate.

Consistent with their attempts to avoid paying the "fair" compensation required by Congress, the interexchange carriers also seek to avoid paying interim compensation. But the Commission cannot abandon the interim compensation mechanism now, four months after it required LECs to eliminate payphone cost recovery elements from their intrastate and interstate rate structures. The statute requires the Commission to eliminate the subsidies formerly used to support LEC payphones "in favor of" a system of per-call compensation. 47 U.S.C. § 276(b)(1)(B). It does not permit the Commission to eliminate LEC payphone cost recovery elements in favor of nothing.

Moreover, even though the interexchange carriers convinced the Court of Appeals to *overturn* the Commission's decision to allocate interim compensation obligations based on total toll revenues, they *propose* that the Commission rely on total toll revenues once again on remand. But this would be inappropriate for precisely the reasons given by the Court of Appeals: the absence of any "nexus" between total toll revenues and the volume of compensable calls carried by each company. Indeed, this methodology would overstate LEC obligations by over 300 percent, allocating to them 12 percent of the burden even though they carry fewer than 3 percent of compensable calls. For the interexchange carriers to try and foist their obligations onto LECs is unsurprising. But for them to do so by suggesting that LEC obligations be calculated using the very methodology they opposed on appeal, and that the Court of Appeals rejected, is beyond the pale of responsible advocacy.

Unfortunately, the intransigence exhibited by the interexchange carriers in their comments typifies their conduct throughout this proceeding. To date, they have openly flouted the

Commission's orders by refusing to perform one of the most critical functions in interim compensation -- actually paying LEC PSPs their due. They have refused to pay even after accepting the benefits of the reduced carrier common line charge that resulted from the same orders. They have refused to pay even after raising their rates to customers for the stated purpose of being able to pay. And they have refused to pay even after denouncing the Commission's orders, and blaming price hikes on the Commission, before the public and the press. Accordingly, at the same time the Commission revises its interim compensation mechanism, it must fix this critical problem and ensure that the interexchange carriers actually pay what they owe.

I. A FULLY AND FAIRLY COMPENSATORY PER-CALL COMPENSATION RATE MUST EXCEED THE LOCAL COIN RATE BY AT LEAST $.07 PER CALL

A. Market-Based Pricing Produces "Fair" Compensation Levels that Are Efficient and Consistent with the Mandate of the Court of Appeals

Time and time again, the Commission properly has recognized that the best determinant of "fair compensation" is the amount of compensation that the market itself provides. Notice of Proposed Rulemaking, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 6716, 6726, ¶ 16 & n.54 (1996) (PSPs are "'fairly compensated' for" calls in market transactions because they "would not enter into" transaction if it did not "compensate them fairly for the use of their payphone equipment") ("NPRM"); Report and Order, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 20541, 20567, ¶ 49 (1996) ("the most appropriate way to ensure that PSPs receive fair compensation for each call is to let the market set the price for individual calls") ("Report and Order"); id. at 20577, ¶ 70 ("[w]e conclude further that the appropriate per-call compensation amount ultimately is the amount the particular payphone charges" for calls in the open market "because the market will determine the fair compensation rate for those calls").

Indeed, market-based prices are not only "fair" -- no party would enter into the transaction if the pricing were unfair, NPRM, 11 FCC Rcd at 6726 n.54 -- but consistent with Congress's command that the Commission promote competition and widespread deployment of payphones. As Congress and the Commission expressly concluded, competition, not regulation, is the best means of "promot[ing] the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1). "[M]arket-based pricing will result in a greater availability of payphones at more economically efficient prices, which will ultimately benefit callers." Order on Reconsideration, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 21233, 21265, ¶ 61 (1996) ("Recon. Order").

Consistent with this conclusion, the Commission has declined to rely on artificial, regulatory, cost-of-service measures when establishing per-call compensation.[2] Instead, it has sought to establish per-call compensation rates that are commensurate with those that the market itself would establish. Because the market provides the best insight into that pricing, the Commission must establish default per-call rates based on competitively-established outcomes. Unlike regulatory, cost-accounting based measures, market-based pricing does not require the imposition of extensive cost-accounting rules on a competitive industry or expensive and contentious rate-setting proceedings. Instead, it is self-adjusting to changing economic circumstances. More important still, market-based pricing (unlike average cost pricing) will not

2. See Illinois Pub. Telecom., 117 F.3d at 560 ("In determining the rate at which PSPs should be compensated for access code calls, subscriber 800 calls, and other toll-free calls, the Commission rejected [a] cost-based approach, which attempts to approximate a PSP's actual cost for each type of call.").

unduly "limit[] a PSP's recovery of its costs" in higher cost and lower volume areas and thereby "lead to a reduction in payphones" -- a result that is flatly inconsistent with Section 276's purpose of "'promot[ing] the widespread deployment of payphone services to the benefit of the general public.'" Id. at 21267, ¶ 66. Instead, market-based pricing accommodates the "likely cost" and volume "variations" from region to region and "payphone to payphone." Id. at 21268-69, ¶ 71.

Despite these compelling arguments, some carriers argue that the Commission is required to rely on cost-based rather than market-based rates. These arguments are all without merit.

1. *The Court of Appeals' Decision Requires Adjustments to, Not Abandonment of, the Commission's Market-Based Proxies*

Rather than attack the Commission's reasons for relying on market-based proxies in setting per-call compensation, several carriers argue that the Court of Appeals' decision requires the Commission to abandon its reliance on market-based proxies. AT&T Comments at 8; CompTel Comments at 11; LCI Comments at 4. This is simply false. Even though the interexchange carriers vigorously argued to the Court of Appeals that the Commission had erred in abandoning cost-based rates,[3] the Court of Appeals did not question the Commission's decision to rely on market-determined prices rather than regulatory accounting approaches. To the contrary, rejecting various challenges to the Commission's decision to allow the market to set the rate for local coin calls, the Court concluded that the Commission's "market-based approach" would provide "fair" rather than excessive compensation for local coin calls. See Illinois Pub. Telecom., 117 F.3d at 562 (rejecting claims that the resulting compensation would be excessive);

[3] See, e.g., Joint Brief of Interexchange Carriers, No. 96-1394, at 30 (D.C. Cir. Feb. 14, 1997) ("Joint Brief of IXCs") (contending that the FCC's "decision to treat deregulated rates as surrogates for costs" was flawed); id. at 36 ("the FCC's reasoning in rejecting TSLRIC is unsupported by the record, contrary to the FCC's other determinations, and thus arbitrary and capricious").

id. at 563 ("A market-based approach is as much a compensation scheme as a rate-setting approach.").

Indeed, the Court rejected the interexchange carriers' arguments on this issue entirely except in one, narrow respect. The Commission had decided that "the compensation rate for 800 and access code calls should be equal to the deregulated local coin rate" because the "costs" of these services were all similar. 117 F.3d at 563 (emphasis added). But, according to the Court, the Commission failed to address record evidence suggesting "the costs of local coin calls versus 800 and access code calls are not similar." Ibid. (emphasis in original); but see Recon. Order, 11 FCC Rcd at 21268, ¶ 71 (concluding that even "[i]f there are significant cost differences between local coin calls and other types of calls . . . the market will address these differences and dictate appropriate per-call compensation amounts for each type of payphone call."); Illinois Pub. Telecom., 117 F.3d at 564 (agreeing with FCC conclusion that carriers can bargain for lower rates).

Thus, contrary to the contentions of some commenters, the Court of Appeals did not require the Commission to *abandon* its market-based proxies. Instead, the Court simply required the Commission to *consider* alleged differences in the costs of originating -- and any other appropriate differences between -- coin and coinless calls. See TCG Comments at 2-3 (Court did not vacate the Commission's conclusion that market rates would best meet the statutory requirement). As explained in Part I-B infra, however, accounting for those differences does not in any way suggest that linking the per-call compensation rate to the local coin rate produces excessive compensation. To the contrary, it shows that the Commission should set the per-call compensation rate at the local coin plus at least $.07.

2. *MCI Cannot Explain Why Market-Based Pricing is Contrary to the Public Interest*

Unhappy with the default rate that competition produces, MCI argues that "a market-based rate for subscriber 800 and [dial-around] calls is not in the public interest." MCI Comments at 3. It is hard to see how MCI can make this argument with a straight face. Nowhere does MCI explain how the public interest favors allowing *it* to offer *its services* at market-based rates but not allowing PSPs to do likewise. Moreover, MCI nowhere disagrees with the Commission's express conclusion that "market-based pricing will result in a greater availability of payphones at more economically efficient prices, which will ultimately benefit callers." Recon. Order, 11 FCC Rcd at 21265, ¶ 61.[4]

Attempting to clothe its pursuit of below-market rates in the cloak of public interest, MCI piously argues (at 4) that market-based prices may lead to call blocking, which is contrary to Congress's goal of "promoting the widespread availability of payphone services." But there is no reason to believe that the market will not respond to prevent this from occurring. Indeed, once MCI finishes its development of blocking capabilities,[5] it can announce that it will block all payphone calls that are not priced at or below a certain rate. Because PSPs have an interest in seeing calls completed -- a blocked call generates no compensation at all -- there is every reason

4. AT&T's similar arguments that prices must be linked to costs are, for like reasons, wholly without merit.

5. Airtouch contends that carriers are unable to block payphone-originated calls based on the per-call compensation amount. Presumably fearing that it (and other 800 subscribers) will end up footing a bill that exceeds carriers' per-call compensation costs, Airtouch argues that the Commission should preclude carriers from passing their compensation costs through to their 800 subscribers. Airtouch Paging Comments at 8-9. This is both inappropriate and unnecessary, since MCI admits (at 4) that it will be able to deploy blocking before per-call compensation begins to fluctuate with the local coin rate. Moreover, if MCI can deploy the necessary technology, the other carriers can do likewise.

to believe that a mutually-acceptable, market-based rate will result. Indeed, the Commission expressly contemplated as much in its order, Recon. Order, 11 FCC Rcd at 21268-69, ¶ 71,[6] and the Court of Appeals has expressly affirmed this finding, Illinois Pub. Telecom., 117 F.3d at 564 (agreeing with the Commission's conclusion that interexchange carriers can "negotiate" for lower rates using their "ability to block" as leverage).[7]

MCI's objection thus stems not from altruism but rather from its own private interest in obtaining PSP services at below-market prices. Pricing PSP services at below-market rates -- and thereby causing sub-market payphone deployment in violation of Section 276's commands -- may be consistent with MCI's interests, but it cannot be reconciled with the interests of the public.

Attempting to substitute verbal sleight-of-hand for reasoned analysis, AT&T contends that market rates are not good proxies for "the cost" of the services being provided. AT&T Comments at 3-4. But AT&T's argument misses the point. The Commission did not rely on market rates to approximate the costs of originating dial-around or access code calls. Indeed, because most payphone costs are joint and common, any attempt to approximate costs for individual call types would have to rely on inherently arbitrary allocations. Instead, the

6. As the Commission explained, "carriers that are concerned about overcompensating PSPs for subscriber 800 calls have substantial leverage, by way of the ability to block these calls from all or particular payphones, to negotiate with PSPs about the appropriate per-call compensation amount." Ibid. It therefore correctly concluded that, even "[i]f there are significant cost differences between local coin calls and other types of calls . . . the market will address these differences and dictate appropriate per-call compensation amounts for each type of payphone call." Id. at 21268, ¶ 71.

7. For the same reasons, MCI's claim (at 4) that it lacks the resources to negotiate with every PSP in the nation is without merit. See also Comments of General Communications Inc. at 3 (same). MCI can simply issue an announcement that it will block all calls from payphones charging per-call compensation in excess of its stated price, and rely on the market to bring PSPs into line. There is absolutely no requirement that MCI actually negotiate an agreement with each individual PSP.

Commission used market proxies to approximate the price the market would charge for those services. As the Commission explicitly concluded, "the PSP will be providing a competitive service (payphone use) and should therefore receive compensation equal to the market-determined rate for providing this service." Recon. Order, 11 FCC Rcd at 21267, ¶ 68.[8]

Indeed, as explained in the Coalition's initial comments on remand (at pp. 20-24), and in greater detail below, where a large proportion of total costs are joint and common across multiple services, it does not make sense in a competitive market to base prices on an abstract, regulatory accounting cost allocations. Instead, a competitive market prices efficiently by taking conditions of demand into consideration as well. Ignoring conditions of demand, as AT&T urges the Commission to do, would produce sub-market rates that are inconsistent with widespread deployment. For this reason too, the Commission properly rejected cost-based pricing and concluded that market-based pricing will produce efficient and widespread deployment of payphones, in accord with Congress's express commands. Coalition Remand Comments at 27-28; Hausman Decl. ¶¶ 37-41 (attached to Coalition Remand Comments).

3. *Neither Section 276 Nor the Commission's Prior Orders Preclude Reliance on Market-Based Rates*

Unable to rely convincingly on the Court's decision or on the public interest, some carriers argue that Section 276 requires the Commission to rely on costs. See Frontier Comments at 3 ("[t]he statute requires cost-based compensation"). Nothing could be further from the truth.

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8. CompTel's similar argument -- that the Commission already has concluded in the Report and Order that fair compensation means compensation tied to arbitrary measures of PSP costs, CompTel Comments at 11, fails for the same reason. The Commission rejected cost-based methodologies as inappropriate. Illinois Pub. Telecom., 117 F.3d at 560 ("In determining the rate at which PSPs should be compensated for access code calls, subscriber 800 calls, and other toll-free calls, the Commission rejected [a] cost-based approach, which attempts to approximate a PSP's actual cost for each type of call.").

While other provisions of the Telecommunications Act require cost-based pricing, Section 276 studiously avoids using any of the usual code words for rate of return regulation, such as "cost-based" or a "reasonable" return on investment. Recon. Order, 11 FCC Rcd at 21267, ¶ 68 (Section 276's requirement of "fair" compensation "is a different standard than the cost based standard articulated for the compensation of interconnection and unbundled elements."). Instead, it requires only that compensation be fair. Accordingly, there is no reason to upset the Commission's conclusion that "Congress did not mandate a cost-based standard for [determining fair] compensation." Id. at 21266, ¶ 66.

Equally meritless is Cable & Wireless's amorphous contention that "cost-based compensation is the only rate that is 'fair' to all entities." Comments of Cable & Wireless, Inc. at 6 ("C&W Comments"). There is nothing fair about a cost-based methodology, which allows recovery of costs from different services under a fixed, regulatory formula, even when buyers place a higher value on one product or service than another. Similarly, there is nothing "fair" about being guaranteed a full return on investment on each service if the market indicates that the product or service is worth less. To the contrary, as the Commission already has observed, in a competitive market, the "fair price" *is* the market price. NPRM, 11 FCC Rcd 6726, ¶ 16 & n.54; Report and Order, 11 FCC Rcd at 20577, ¶ 70.[9]

4. *WorldCom's and MCI's Argument About Locational Monopolies is Foreclosed and Wholly Without Merit*

Finally, recognizing that a competitive market produces fair compensation, WorldCom and MCI argue that the payphone market is not competitive, and that locational monopolies will

[9] This approach to "fair" compensation is entirely consistent with ordinary usage. The "fair" value of a good or service is the "fair market value," i.e., the price at which both buyers and sellers are willing to do business in a free and open market. Webster's Ninth Collegiate Dictionary at 445 (1989).

preclude competitive pricing. WorldCom Comments at 3-4; MCI Comments at 2-3. But the Commission and the Court of Appeals alike have heard these arguments[10] and rejected them before. The Commission's orders explain in great detail that the conditions of supply and demand, as well as empirical evidence, all point toward a competitive market.[11] The Court of Appeals, in no uncertain terms, agreed:

> The petitioners and intervenors failed to present any evidence that there are significant locational monopolies in the states that have already deregulated their local coin rates; accordingly, it was not unreasonable for the Commission to conclude that market forces generally will keep prices at a reasonable level, thereby making locational monopolies the exception rather than the rule. If locational monopolies turn out to be a problem, however, the Commission suggested some ways in which it might deal with them . . . .

Illinois Pub. Telecom., 117 F.3d at 562.

WorldCom and MCI wholly ignore this clear holding. They present no new evidence, information, or argument concerning the state of competition. Accordingly, there is no reason for the Commission to reconsider its well-reasoned and judicially affirmed conclusion that per-call compensation can and should be established through market-based rates.

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10. See AT&T Petition for Reconsideration and Clarification at 11-12 (FCC Oct. 21, 1996) ("'locational monopolies' are the rule rather than the exception for coin phones and they preclude the existence of a 'market-based' competitive price . . . "); Joint Brief of IXCs at 32 ("[T]he FCC's failure to consider the conceded monopolistic aspect of payphones in determining to use the local coin rate as the basis for its per call compensation scheme renders its action arbitrary and capricious."); id. at 26-33; Joint Brief of Utility Regulatory Commissions of the Various States at 13-15 (D.C. Cir. Apr. 23, 1997).

11. As the Commission explained, there is no reason to expect locational monopolies because there are multiple players in the market; a high degree of rivalry; and barriers to entry and exit are low. Report and Order, 11 FCC Rcd at 20577, ¶ 70; Recon. Order, 11 FCC Rcd at 21267, ¶¶ 67-68. Under these conditions, market forces -- not cost-based regulatory review -- are "best able to set the appropriate price for payphone calls in the long term." Report and Order, 11 FCC Rcd at 20577, ¶ 70. See also Recon. Order, 11 FCC Rcd at 21267, ¶ 68 ("market forces [will] provide for efficient pricing of these services in the near future."). Moreover, the Commission warranted that, in the event that state authorities could demonstrate that locational monopolies or market failure was distorting local coin call pricing, the Commission would allow state intervention or intervene on its own. Id. at 21259, ¶ 51.

B. An Efficient and Competitive Market Would Price Subscriber 800 and Access Code Calls at Least $.07 Per Call Higher Than Local Coin Calls

Although the Court of Appeals' decision does not require the Commission to abandon its reliance on competitive outcomes, it does require the Commission to perform some additional analysis. In particular, the Commission must consider relevant differences between the service for which default rates are being set (access code and subscriber 800 calls) and the service being used as a proxy.

1. *Accounting for Cost Differences Shows That the Local Coin Rate Affords PSPs Too Little Compensation*

One potential difference identified by the Court of Appeals and the Commission on remand was a difference in cost. In response, several interexchange carriers have endorsed the avoided cost methodology. See Excel/Telco Joint Comments at 2-4; Midcom Comments at 6-7. Under this approach, any costs avoided when a subscriber 800 or dial-around call is made instead of a local coin call are deducted from the competitive local coin rate. Coalition Remand Comments at 15-16. The corollary, of course, is that costs imposed on PSPs by virtue of the fact that the call is not a local coin call also must be added. Id. at 17-19.

As the Coalition pointed out, this analysis does not support an offset against the local coin rate. See id. at 15-24. To the contrary, the total avoided cost (coin collection and local usage charges) is in the range of $.04 per call, and once any additional ANI ii costs are accounted for, the net avoided cost becomes *negative*. Id. at 19.[12]

Unsurprisingly, the independent calculations of non-Coalition PSPs produce similar results. The APCC found that avoided costs amounted to, at most, $.05 to $.06 per call. APCC

[12] As the Coalition explained, the Commission should avoid imposing excessive and unnecessary payphone digit identification costs on PSPs by rejecting AT&T and MCI's interpretation of the Reconsideration Order. See Coalition Remand Comments at 18-19; LEC Whitepaper on the Provision of ANI Coding Digits (FCC June 16, 1997).

Comments at 11-15. But the APCC, Peoples, and other independent PSPs, also identified additional collection-related costs, imposed uniquely by dial-around and subscriber 800 calls, about which Coalition members were unaware. For example, since Coalition members have yet to be paid anything by most carriers -- the carriers have simply refused to pay -- the Coalition had no basis for estimating carrier uncollectibles (unless they were set at 100 percent). The APCC, however, reports that uncollectibles for such calls run in the range of 8 percent, or about $.03 per call. Id. at 14.[13] Similarly, because virtually no carriers have paid Coalition members, the Coalition was not aware that payments typically are delayed for months on end. The APCC reports that late payments, which impose losses based on the time value of money, add an additional $.01 per call. Id. Finally, the APCC estimates that the administrative expenses associated with per-call compensation will be in the range of $.01 to $.02 per call. Id. at 15; see also TCG Comments at 6-7 (citing administrative delays inherent in collecting per-call compensation).

The Coalition finds no reason to doubt the APCC's figures. To the contrary, based on its limited experience with carrier payment (or, better put, recent but extensive experience with carrier non-payment), the Coalition believes that these estimates for LEC PSPs may turn out to be conservative. See pp. 57-59, infra (discussing widespread interexchange carrier refusals to pay). Accordingly, the Coalition has asked Andersen to revise its net avoided cost analysis to take these additional costs into account. See Carl R. Geppert, Critique of Cost Studies and Other Issues 13 (Sept. 9, 1997) (attached hereto) ("Andersen Remand Reply Report").

13. Paging Network's assertion (at 14) that uncollectibles are "a significant expense not associated with 800 subscriber calls" is simply wrong. As the APCC's experience demonstrates, carriers often fail to pay for per-call compensation.

AVOIDED COSTS		
Cost Type	**Mean**	**Modal**
Local Usage[14]	-$.02	$.00
Coin Collection	-$.02	-$.03
ANI ii[15]	+$.05 TO $.08	+$.05 TO $.08
Uncollectibles (APCC)	+.03	+.03
Interest (APCC)	+.01	+$.01
Admin. Costs (APCC)	+$.01	+$.01
TOTAL	+$.06 TO $.09	+$.07 TO $.10

As demonstrated above, these calculations show that a proper avoided-cost methodology would not produce a per-call compensation rate lower than the local coin rate. To the contrary, it requires compensation that exceeds the local coin rate by at least $.06, and as much as $.10, per call.

2. *Accounting for Conditions of Demand Demonstrates That Per-Call Compensation Must Exceed the Local Coin Rate by at Least $.07 Per Call*

Reliance on an avoided-cost methodology alone, however, will fail to reproduce competitive outcomes. As the Coalition and Professor Hausman have pointed out, in industries (like the payphone industry) where joint and common costs make up a large proportion of total costs, the competitive market does not price the goods or services based on costs alone. Coalition Remand Comments at 20-24; Hausman Decl. ¶¶ 19-29. To the contrary, each producer

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14. As explained in the Coalition's opening comments, a majority of Coalition members use flat-rated lines and thus do not incur local usage charges.

15. If the Commission allows LECs to identify payphones using their choice of Flex ANI or OLNS technology, as contemplated in the Commission's OLS Order, see Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, 11 FCC Rcd 17021 (1996), payphone identification digit costs for the subscriber 800 and access code calls might be as little as $.01 per call. Coalition Remand Comments at 18 n.6; Andersen Remand Report at 7.

prices goods and services in inverse proportion to the relative elasticity of demand for each good or service, recovering a large portion of joint and common costs from goods and services with low elasticities, and a smaller portion from those with higher elasticities. Coalition Remand Comments at 20-21; Hausman Decl. ¶¶ 20-21.

Because the derived demand elasticity for dial-around and subscriber 800 calls is much lower than that of local coin calls, a competitive market would price those calls much higher than the local coin rate. Coalition Remand Comments at 22-23. This is clearly demonstrated by the relative prices given to 0+ and local coin calls. Even though 0+ calls are alleged (by the interexchange carriers) to avoid coin collection and local usage charges, they are priced higher, not lower, than local coin calls. Ibid.; Hausman Decl. ¶ 22. Indeed, they are priced at approximately three times the local coin rate. Coalition Remand Comments at 22-23. Professor Hausman calculates that, for the same reasons, the market price of dial-around and subscriber 800 calls also would be higher than the local coin rate, by at least $.07 per call. Hausman Decl. ¶¶ 28-29, 47; Coalition Remand Comments at 23.

These results are wholly consistent with the market-based proxies used by the Commission in 1992. As the APCC's and the Coalition's opening comments demonstrate, those market-based proxies, even adjusting for the lower revenue potential of subscriber 800 calls, produce compensation rates well above the competitively established, prevailing local coin rate. See APCC Comments at 9-10 (weighted average rate of $.46 per call); Coalition Remand Comments at 25-26 (rates range from $.39 to $.63 per call).